INTRODUCTION

RELEVANCE OF THE SUBJECT

India’s position as a global economic force, *inter alia*, mandates the need for a robust regulatory framework for its securities market, to boost the confidence of both the domestic and the international investors that their money is safe in a fair and transparent securities market. In the recent years, India has witnessed large price fluctuations in the shares of public companies during the periods of mergers or acquisitions and illegal trading on the basis of unpublished price sensitive information, which has caused great concern to the Indian securities market. If the fiduciaries who run the companies for the benefit of the shareholders gain unjust enrichment at the cost of the company and its shareholders, it becomes a heinous crime.

Although illegal insider trading is a global phenomenon, a study by the IMF reports that it is relatively high in countries such as India, China, Russia, etc., resulting in high volatility in share prices. Indian studies also have reported that insider trading activity is observed amongst companies belonging to the same business group prior to merger announcements.

HYPOTHESIS
As the Indian market does not have a level playing field or perfect competition, asymmetry of information causes an adverse impact on the market. Therefore, the adequacy of regulations and an efficient enforcement mechanism to curb insider trading becomes very important to avoid manipulators and fraudsters taking advantage of the information asymmetry.

OBJECTIVE OF THE STUDY

The purpose of the study has been to analyze the regulatory infrastructure of the insider trading laws in India and decide on the strategy to improve upon the existing framework. With that objective, the author has trailed through the laws relating to insider trading both in the U.S. and U.K., which are reputed for their efficacy.

SCOPE OF THE STUDY

The history and evolution of insider trading laws in India dates back to the high level committees set up by the government to review the laws relating to financial markets in India, such as the Thomas Committee of 1948. The recommendations evolved into the initial forms of legislation under sections 307 and 308 of the Companies Act, 1956 which stipulated that directors and managers of companies must disclose their shareholding and their dealings in the company’s shares. However, the Companies Act did not have a scheme or
adequate provisions for the effective regulation of insider trading activities. The Sachar Committee of 1977 as well as the Patel Committee of 1984 also emphasized the requirement of a separate statute to curb insider trading.

In 1992, the Indian Parliament enacted the Securities and Exchange Board of India Act, 1992 with the mandate of protecting the interest of investors in securities and to promote the development of and regulate the securities market. Section 11(1) (g) of the SEBI Act empowered the Securities and Exchange Board of India to initiate measures prohibiting insider trading in securities. Accordingly, the SEBI (Prohibition of Insider Trading) Regulations, 1992 were framed. Regulation 3 of the Insider Regulations prohibits an insider who possesses unpublished price sensitive information from dealing, communicating or counselling in securities. Since its inception, the SEBI had adopted several measures to strengthen the enforcement of the Insider Regulations and it has been a difficult task for SEBI to convince the courts about the complex facts involved in insider trading cases.

Notwithstanding the difficulties in proving them, SEBI has been prosecuting a number of high profile insider trading cases. The first case where SEBI had enforced the Insider Regulations was that of Hindustan Lever in 1998. This was followed by the cases of Rakesh Agarwal (2001), Samir Arora (2003), DSQ Holdings (2003), Dilip Pendse (2009), Dr. Anjali Beke (2005), Rajiv B. Gandhi (2007), KLG Capital (2009) and lastly that of
Manmohan Shetty (2010). In the Manmohan Shetty’s Case, the SEBI had imposed a penalty of ten (10) million rupees for the violation of the disclosure norms prescribed under the Insider Regulations. In some of the cases stated above, SEBI’s orders were upheld by the appellate body, the Securities Appellate Tribunal. Although two of the recent cases are pending decision, the remaining orders were set aside by the SAT on grounds of lack of jurisdiction, ambiguity in the principles and law governing insider trading in India, etc. However, none of the cases on insider trading have been subjected to the scrutiny of the High Courts or the Supreme Court of India which are the judicial bodies to interpret the validity of a law and establish precedents.

The Insider Regulations were amended from time to time, mainly in 2002 and thereafter, in 2008. However, the success rate in enforcement of the Insider Regulations is very less in India as opposed to other countries. It is also a fact that the existing regulatory framework does not provide for a sufficiently deterrent environment against insider trading.

THE METHODOLOGY OF THE STUDY

The first chapter of this study analyses the fundamentals of the insider trading regulation, the need for regulation on insider trading, the different theories that justify a prohibition on insider trading, etc., as well as the validity of the critical approach that insider trading improves market efficiency.
The second chapter consists of a detailed study of the existing regulatory framework in the U.S., where the enforcement actions against insider trading violations have evolved through the judicial process. This chapter evaluates various theories that have supported the regulatory actions against insider trading in the U.S. Further, the regime in U.K., which has undergone significant changes pursuant to the directives of European Economic Community has been analyzed.

The third chapter traces the development of insider trading laws in India, and case law that have been decided by the SEBI and the appellate bodies.

The fourth chapter examines the provisions of law in the three jurisdictions of U.S., U.K. and India regarding the following: (a) What is insider trading; (b) Who can be considered as an ‘insider’; (c) What is ‘inside information’; and (d) How to prevent insider trading.

In the comparative study on the development of insider trading laws in these jurisdictions, the impact of the timely changes in their laws on their respective regulatory environment was scrutinized.

The fifth chapter analyzes the different sanctions and methods of enforcement available under the U.S., U.K., and India. The chapter five also
deals with the enforcement challenges. The World Bank assessment (the ROSC), 2004 has identified that despite several legal developments, enforcement and implementation of laws and regulations remain important challenges. Consequently, the report made certain recommendations. The World Bank assessors strongly felt that sanctions and enforcement for related party transactions and insider trading should effectively ensure alignment of business practices with good corporate governance practices.

As insider trading is a white collar crime, the offence of insider trading requires a special treatment as opposed to other securities law violations is the subject of scrutiny under chapter six.

In chapter seven, the author discusses the adequacy of the regulatory infrastructure in India. The probe into the origins of the insider trading laws in India, the existing legal framework including statutory provisions and the case law has revealed that the Insider Regulations in India is progressive, robust and conclusive, barring some ambiguities, legislative inconsistencies and complexity in the definitions. While pointing out the lacunae and loopholes about the existing legal framework, proposals regarding modifications to the laws on insider trading and its enforcement mechanism in India, based on the analysis of the international experience have been discussed. The prohibitory regime and the disclosure mandates have been tailored into the same regulation, which provides the double-edged purpose of deterring and
penalizing the act of insider trading. Further, the deterrent features of the Insider Regulations' stringent disclosures are criticized.

In concluding the reasons for the inefficiencies in enforcement of the Insider Regulations, the author has analysed the various factors that have negatively impacted its enforcement. The major factors include the lack of clarity displayed while combining criminal and civil liabilities attached to the violation, reading the statute as one of strict liability, having to cross hurdles in the several definitions provided by the statute to establish the violation, heavy reliance on the ‘fiduciary theory’ and lack of powers to investigate the cases of insider trading as SEBI lacks the authority for wire tapping etc. Additionally, the SEBI does not have explicit powers to investigate suspected cases of insider trading against persons and entities not regulated by the SEBI.

It appears that although the Insider Regulations has specified various prohibited class of insiders and insider trading activities, absence of stringent penal consequences result in diluting the Insider Regulations’ deterrent value. One of the reasons may be the safe feeling amongst the worst possible penalty for violation of insider trading laws cannot be anything more than the monetary penalties or debarment from market participation, to be imposed by SEBI, which can be challenged in the appellate tribunals or higher courts.
Additionally, proving of insider trading violations has been cumbersome for the regulator which obviously benefits the violators. The methodology suggested by the author to improve upon the enforcement in India is to rely upon the civil regime, on detection of violation. The enforcement of securities laws depend crucially on two pillars: the characteristics and powers of the regulator and the efficiency of the courts. The inconsistency of the appellate bodies reflected in their decisions on the same issues send signals to the market that the enforcement regime is not strong enough. For instance, the appellate body had interpreted the issue of burden of proof in insider trading cases in different ways on separate occasions. However, there has been progressive change in the appellate bodies' approach. If the appellate body follows a consistent and rational approach as in the case of Rajiv B. Gandhi, it will alleviate the maladies in establishing the burden of proof and improve the enforcement regime of insider trading laws in India.

The author further suggests that has recommended by the Dhanuka Committee, the burden of proof should be shifted to the accused while resorting to the enforcement of criminal penalties.

A large volume of detailed, prescriptive and highly complex rules can divert attention towards adhering to the letter rather the purpose of regulatory standards. Therefore, the complexities in definitions should be dispensed with.
There is a need to dilute the clauses that prescribe the conditions to be fulfilled in order to come within the definition of ‘insider’, i.e., connected person, deemed connected person, etc.

The U.S. insider trading laws, known for its strong enforcement regime has recently tightened its vigilance on hedge funds with an intention to work backwards and trace the violators involved at various stages. As the Indian capital market has a state-of-the-art surveillance mechanism it will also undertake similar exercise.

Globally, private rights of action and class action supervised by responsive courts are successful in protecting investors and enforcing securities laws. Section 26 of the SEBI Act provides that no court shall take cognizance of an offence punishable under the SEBI Act or any rules or regulations made there under, except on a complaint made by the SEBI. Under Indian securities law, there is not much scope for class action. Indian investors do not have the ability to bring a meaningful private action or class action for violation of securities laws. Further, in securities market related cases in India, Public Interest Litigations were mostly disallowed by the courts. Under a modified legal regime, if class actions could be initiated for violation of the securities laws, market forces could provide an effective avenue for shareholder redress; for disciplining securities market professionals and insiders and for assisting SEBI in enforcing the securities laws.